DEPARTMENT OF STATE REVENUE

04-20140503.LOF

Letter of Findings: 04-20140503
Gross Retail Tax
For the Years 2010, 2011, and 2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Indiana Truck Dealer was required to collect sales tax from its customers on the price Truck Dealer charged its customers for subcontractor costs because the charges represented unitary transactions. Truck Dealer failed to establish that the audit's sampling methodology was flawed and that the resulting assessment overstated its sales tax liability. The Department was correct in assessing sales tax on the price Truck Dealer paid for computer software and software maintenance agreements.

ISSUES

I. Gross Retail Tax - Subcontractor Repair Charges.

Authority: IC § 6-2.5-1-1; IC § 6-8.1-5-1(c); IC §6-2.5-2-1; 45 IAC 2.2-2-2 ; 45 IAC 2.2-7-4; Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014).

Taxpayer argues that charges on its customer invoices designated as "sublet" costs represent separate charges for labor and materials and that the Department's decision assessing tax on the total sublet charges was erroneous.

II. Gross Retail Tax - Audit Sample.

Authority: IC § 6-8.1-3-12(b); IC § 6-8.1-5-1(c); Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480 (Ind. Tax Ct. 2012).

Taxpayer maintains that the audit sampling methodology is flawed because it includes in its sample tire sales transactions which occurred at only one of its business locations.

III. Gross Retail Tax - Miscellaneous Charges.

Authority: IC § 6-8.1-5-1(c); IC § 2.5-1-1; American Heritage Dictionary of the English Language (1st ed. 1969).

Taxpayer claims that it was not required to collect sales tax from its customers on separately stated "miscellaneous charges" because the charges represent exempt labor costs.

IV. Gross Retail Tax - Computer Software and Software Maintenance Agreements.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-1; IC § 6-2.5-1-27; IC § 6-2.5-1-24; IC § 6-2.5-4-17; Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); Sales Tax Information Bulletin 2 (March 2013); Sales Tax Information Bulletin 2 (December 2006).

Taxpayer disagrees with the assessment of sales/use tax on the cost it paid for computer software and computer software maintenance agreements.

STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of selling large and medium sized trucks and truck parts.

Taxpayer also operates parts and service departments at its multiple Indiana business locations. Taxpayer sells trucks. Taxpayer also repairs and services customer vehicles. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's business records and tax returns. The audit reviewed Taxpayer's "deal jackets" which contain information documenting the sale of Taxpayer's trucks. The audit reviewed documentation detailing the sales of its truck parts and truck service. According to the audit report, "Due to the volume of information to examine, it was agreed to sample the parts and service invoices" and "it would be representative to review the parts and service activities of all locations through a single stat sample." The audit report stated:

> A statistically based sample was performed on these sales provided by the taxpayer using the audit command language software . . . [to] arrive at projected taxable sales. The audit adjustments from sampled strata [would] be allocated to entities in proportion to its share of sampling dollars in the [strata]. The audit adjustments from the detailed stratum [would] be directly assigned to the appropriate legal entity. The statistical sample revealed that the 2012 error rate was 1.0410[percent]. . . .The error rate was used to compute additional taxable sales for 2010 and 2011 based on the total account balances for parts and service receipts.

The audit resulted in the assessment of additional tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer explained the basis for its protest. This Letter of Findings results. Additional facts will be provided as necessary.

I. Gross Retail Tax - Subcontractor Repair Charges.

DISCUSSION

The Department determined that Taxpayer had not properly collected sales tax on certain transactions. Specifically from Taxpayer's service and parts division, the audit concluded as follows:

> The stat sample revealed that sales tax was not correctly charged and remitted on some invoices. The [T]axpayer failed to collect tax on sublet parts in the body shop (including glass, parts, tires and paint) for taxable customers. The review also revealed that sales tax was not collected on all taxable customers. These customers did not provide a valid exemption certificate and should have been charged sales tax. (Emphasis added).

Therefore, the audit assessed sales tax for the customers invoiced sublet charge on the customer invoices. In support of its decision assessing additional tax, the audit cited as authority 45 IAC 2.2-2-2 which provides as follows:

> The retail merchant, acting as an agent for the state of Indiana, must collect the tax. The tax is bourne by the customer. Consideration is a necessary element of taxable transaction.

As used by Taxpayer, the term "Sublet Charges" requires an explanation. Taxpayer presents its customers with an invoice which details charges for labor, parts, miscellaneous, and a "sublet amount." The sublet amount is the cost of the work a subcontractor performed on a particular vehicle. In other words, there may be repair work performed on a customer vehicle or a part for the customer invoice which Taxpayer chose not to perform itself but allowed a third-party to perform.

For example, Taxpayer may not be qualified to perform certain sheet metal, body work on one of its customer's vehicles. Taxpayer will select a vendor qualified to do that work, the vendor will perform the work, invoice Taxpayer for that work, and Taxpayer will pass along that cost on its final customer invoice as a charge labeled "sublet amount." The customer will receive a single invoice on which it will see a separate charge labeled "sublet amount." That sublet amount represents the subcontractor's cost to perform the sheet metal, body work.

When Taxpayer charged its customers sales tax on the final invoices, it charged its customers seven percent sales tax on the "parts" itemized it installed on the customer's vehicles but did not charge its customers sales tax on the "sublet" charges on the invoices.

Taxpayer maintains that most of the sublet charges should not be subject to tax and explains that it can now differentiate between exempt labor costs and taxable part costs for each sublet charge. In other words, if Taxpayer charged its customer an original $100 sublet charge, it has now conducted a review of it and its subcontractor's original charges and now is able to explain that the $100 sublet charge actually consists of $30 in

parts and $70 in labor. Taxpayer asks that the Department adjust the assessment to reflect that distinction.

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Further, [W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit, are entitled to deference.

IC § 6-2.5-2-1 provides:

> (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
> (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state. (Emphasis added).

The sublet charges represent "unitary transactions" which are explained at IC § 6-2.5-1-1(a), as follows:

> [A] "unitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.

In addition, IC § 6-2.5-1-5 states:

> (a) Except as provided in subsection (b), "gross retail income" means the total amount of consideration, including cash, credit, property, and services, for which tangible personal property is sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for:
> (1) the seller's cost of the property sold;
> **(2) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;**
> **(3) charges by the seller for any services necessary to complete the sale**, other than delivery and installation charges. . .

(**Emphasis added**).

Transactions that include tangible personal property and services "which are furnished under a single order or agreement and for which a total combined charge or price is calculated" are retail unitary transactions. IC § 6-2.5-1-1(a). Further, 45 IAC 2.2-4-1(b)(3) states that the amount of the retail transaction that is subject to tax includes the amounts collected for "services performed or work done on behalf of the seller prior to transfer of such property at retail." Therefore, the sales tax due on a retail unitary transaction is based on the total price of the transaction.

In this case, Taxpayer charged its customers a single, unitary price for the "sublet charges" but now asks that the Department review the original documentation between itself and its subcontractor to differentiate between exempt service charges and taxable transfers of tangible personal property.

Taxpayer has provided repair orders with corresponding purchase orders for either parts or services provided to the customer. Certain of the purchase orders however, appears to show that certain sublet charges are for labor, which is exempt from sales tax; other purchase orders demonstrated that Taxpayer included these charges at a markup on the customer's invoice. Nonetheless, Taxpayer cannot retroactively go back and separate out any sales tax exempt charges to the customer for the type of cost that Taxpayer incurred. In addition, IC § 6-2.5-1-5(a) states that any costs incurred by seller and passed onto customer (except for delivery and installment) is included in gross retail income. Taxpayer did not itemize or deduct exempt from non-exempt sales transactions at the time it presented the invoice to customers therefore, the assessment based upon the audit's determination that these "sublet charges" are unitary and taxable is correct.

FINDINGS

Taxpayer's protest is respectfully denied.

II. Gross Retail Tax - Audit Sample.

DISCUSSION

Taxpayer disagrees with the sales and use tax assessment on the ground that the audit sample was distorted by including in the sample transactions which occurred at one of its multiple business locations.

Rather than reviewing each and every transaction entered into by a particular taxpayer, the Department has the authority to use a "sampling" method to determine whether the taxpayer is subject to additional tax. IC § 6-8.1-3-12(b) provides:

> The department may audit any returns with respect to the listed taxes using statistical sampling. **If the taxpayer and the department agree to a sampling method to be used, the sampling method is binding on the taxpayer and the department in determining the total amount of additional tax due or amounts to be refunded.** (**Emphasis added**).

On June 11, 2014, Taxpayer signed an "Agreement for Projecting Audit Results" agreeing to the audit sampling methodology because of "the volume of information to examine and obvious time constraints . . . ."

Taxpayer argues that the sampling results were skewed because the sample included transactions at one of its locations which sold tires. Taxpayer does not explain precisely how its assessment would have changed if the tire sales were not included but only that the error rate - and consequent assessment - would have been lower.

As noted in Part I above, IC § 6-8.1-5-1(c) provides that "[t]he notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Consequently, the taxpayer is required to provide documentation explaining and supporting its challenge that the Department's assessment is wrong. Poorly developed and non-cogent arguments are subject to waiver. Scopelite v. Indiana Dep't of Local Gov't Fin., 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); Wendt LLP v. Indiana Dep't of State Revenue, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

In addition, the design of a statistical sample largely eliminates the issue of extraordinary transactions skewing the sample results. Stratification and the opportunity for all records in the population to be selected for review addresses the concerns of projecting extraordinary items that are inherent in block samples.

The transactions included in the audit stat sample which occurred at the Taxpayer's business location may indeed be unique to that location and may have resulted in an assessment larger than expected. However, Taxpayer has provided nothing of substance which would justify an adjustment in that assessment. Taxpayer's protest in this respect is denied because Taxpayer has failed to prove that the assessment was "wrong."

FINDING

Taxpayer's protest is respectfully denied.

III. Gross Retail Tax - Miscellaneous Charges.

DISCUSSION

On its invoices, Taxpayer includes a cost for its "miscellaneous charges." Taxpayer did not charge its customer sales tax on this line-item on the customer invoices. The audit disagreed and apparently assessed additional tax on the line-item on the customer invoices. Taxpayer disagrees and explains that "miscellaneous charges" are a "labor charge" over and above the "labor amount" listed on that same invoice. In effect, Taxpayer asserts that the "miscellaneous charge" represents an additional or "bonus" labor charge.

Taxpayer maintains that it should not have been assessed tax on "miscellaneous charges" because these charges are simply additional "mark-ups" on its standard exempt labor charges.

Taxpayer has provided nothing of substance which would support Taxpayer's assertion that its "miscellaneous

charges" are not subject to sales tax. This particular charge is, of course, designed to be ambiguous ("Made up of a variety of parts or ingredients." American Heritage Dictionary of the English Language 838 (1st ed. 1969)) and remains so in this context. Furthermore, this charge is a unitary transaction as described in Part I of this Letter of Findings, and therefore, is taxable under IC § 2.5-1-1(a). As noted previously, the law requires that the Taxpayer establish that the assessment is wrong not that it is subject to ambiguity. IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

IV. Gross Retail Tax - Computer Software and Software Maintenance Agreements.

DISCUSSION

Taxpayer argues that it was not subject to sales or use tax on the purchase of computer software or computer software maintenance agreements.

The audit found as follows:

> [T]axpayer purchased software and [software] computer maintenance agreements exempt from tax. There is no statutory exemption for these purchases. These items are used by the sales force and in administrative areas.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Ind. Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002) (Emphasis added).

IC § 6-2.5-1-27 specifies that:

> "Tangible personal property" means personal property that:
> (1) Can be seen, weighed, measured, felt or touched; or
> (2) Is in any other manner perceptible to the senses.
> The term includes electricity, water gas, steam, and prewritten computer software. (Emphasis added).

"Prewritten computer software" is defined in IC § 6-2.5-1-24 which provides in part as follows:

> Subject to the following provisions, "prewritten computer software" means computer software, including prewritten upgrades, that is not designed and developed by the author or other creator to the specifications of a specific purchaser:
> (1) The combining of two (2) or more prewritten computer software programs or prewritten parts of the programs does not cause the combination to be other than prewritten computer software. . . .

Taxpayer also purchased software maintenance agreements that - according to the audit report - "provide assurances that any required service and parts will be provided in the event of a break down or malfunction of the covered property."

The audit report also points out that some of the maintenance agreements "also contain provisions for periodic inspection or preventative maintenance where tangible personal property will be supplied as a part of the unitary price."

The Department has unequivocally stated that software maintenance agreements that contain the right to obtain software updates are subject to sales tax.

> Maintenance contracts generally meet the definition of bundled transactions under IC [§] 6-2.5-1-11.5 and are

subject to sales tax on that basis. The determination as to whether a contract is a maintenance contract is not necessarily based on the particular title of or language used in the contract. Instead, the determination is based on the substantive provisions contained in the contract. An explicit guarantee that tangible personal property will be provided under the contract is not required. Sales Tax Information Bulletin 2 (March 2013.) 20130327 Ind. Reg. 045130126NRA; See also Sales Tax Information Bulletin 2 (December 2006) 20100804 Ind. Reg. 045100497NRA.

Therefore, the Department has consistently found that "software maintenance agreements" were subject to sales and use tax with a rebuttable presumption since August 2006. Thus, the Department is not required to determine whether the maintenance agreement vendors did or did not provide Taxpayer with computer software updates or whether the underlying agreement guaranteed that updates would be provided. For the tax year in question, the Department presumes that updates were provided pursuant to the agreement and Taxpayer may rebut this presumption. The Department notes that, as of July 1, 2010, the legislature effectively removed this rebuttable presumption with the enactment of IC § 6-2.5-4-17 (effective July 1, 2010) which provides that "software maintenance agreements" are always subject to tax.

The audit was correct in determining that, under Indiana law; prewritten computer software and software maintenance agreements are ordinarily subject to Indiana's sales and use tax.

FINDING

Taxpayer's protest is respectfully denied.

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